APPROVED BY THE BOARD OF TRUSTEES

JANUARY 18, 1991

OPINION 90-3

CLEVELAND BAR ASSOCIATION
PROFESSIONAL ETHICS COMMITTEE

HEADNOTE

A law firm or legal professional association may not purchase uncollected debts from clients with the intent of collecting such debts in its own name through collection activities and legal action. Nor may a firm purchase debts in which its client has an interest in acquiring.

A legal professional association may not purchase uncollected debts from non-clients with the intent of collecting such debts in its own name through collection activities and legal action. A law firm that is not a legal professional association is not prohibited at present from purchasing uncollected debts from non-clients, provided, a) the firm’s professional judgment will not be compromised, b) there is no risk of appearance of impropriety, c) barratry or stirring up of litigation is avoided. However, in view of the developing opinion within the profession to prohibit ancillary business activities by law firms, it may not be prudent at the present time for a firm to initiate such activities.

STATEMENT OF FACTS

A law firm specializing in creditors’ rights desires to purchase uncollected debts owed to clients and then to collect debts in its own name through collection activities and legal action. The firm also wishes, on its own, to purchase uncollected debts from the Resolution Trust Corporation and the Federal Deposit Insurance Corporation and proceed to collection and legal action on those debts in its own name.

QUESTIONS PRESENTED

1. Whether a law firm or a legal professional association may acquire uncollected debts from a client on some of which debts the firm is providing representation to the client.

2. Whether a law firm or a legal professional association may acquire uncollected debts from non-clients for the purpose of collection and legal action in its own name.

DISCUSSION

DR 5-103(A) of the Code of Professional Responsibility provides that:

A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation he is conducting for a client, except that he may:

(1) acquire a lien granted by law to secure his fee or expenses;
(2) contract with a client for a reasonable contingent fee in a civil case.¹

Plainly, the firm may not obtain a part interest in the debt owned by the client. Nor may the firm purchase the entire interest. Based as it is on the principle of the avoidance of conflicts of interest, DR 5-103(A) does not distinguish between partial or complete proprietary interests, and for good reason. If the firm seeks to purchase the entire debt from the client, it is in no way representing the client against the debtor, but rather, it is substituting its interest for the client’s. Thus, obtaining the debts of a client would deny the client the independent and disinterested professional services of an attorney.² The conflict of interest between the firm and its client would be patent. The firm’s total commitment towards representing the client would be compromised by its desire to acquire the debt on favorable terms. With that interest in mind, the firm might undervalue to the client the probability of collection or the amount likely to be collected. Case law accords. In Office of Disciplinary Counsel v. Williams, 51 Ohio St.3d 36 (1990), the Supreme Court reprimanded an attorney for violating DR 5-103(A) by “acquiring a proprietary interest in claims filed for debts due clients.”

DR 5-103(A) has its historic source in the prohibition against champerty, Key v. Vattier, 1 Ohio 132 (1823), and has been held to serve the same principle. Gennett v. Leichtamer, slip opinion, Case No. CA-5107 (Court of Appeals, 5th Dist., Stark County, September 27, 1979).³ In addition to the ethical constraints of DR 5-103, champertous contracts remain unenforceable under Ohio law.⁴

The ethical considerations underlying DR 5-103(A) also apply when the law firm seeks to purchase even those uncollected debts of a client for which the firm is not providing representation. The market value of certain debts of a client will be directly affected by the level of recovery that the firm obtains for its client on the represented actions. The

¹ Cf. Canons of Professional Ethics, Canon 10; Model Rules of Professional Conduct, Section 1.8(j).

² See Ethical Consideration 1-1 which states that “every person in our society should have ready access to the independent professional services of a lawyer of integrity and competence.”

³ See also Model Rules of Professional Conduct, Comment to Rule 1.8(j). Under Ohio law, champerty is defined as “a bargain between one having an interest in a law suit, either as plaintiff or defendant, and another who is a stranger thereto, whereby such stranger, called the champertor, agrees to carry on the prosecution or defense of such suit at his own expense, in consideration of his receiving a part of the proceeds in the event of a favorable determination of the litigation. Maintenance is an officious intermeddling in a suit that in no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it.” Mahoning County Bar Association v. Ruffalo, 199 N.E.2d 396, 176 Ohio St. 263, 27 O.O.2d 161 (1964) (Herbert, J., dissenting).

⁴ Dombey Tyler, Richards & Greiser v. Detroit, Toledo & Ironton Railroad Co., 351 F.2d 121, 6 Ohio Misc. 185, 34 Ohio Op.2d 99 (6th Cir. 1965); Finders Diversified, Inc. v. Hale Baugh, Case No. L-83-424, slip opinion (Ohio Ct. of Appeals, 6th Dist., Lucas County, April 20, 1984).
firm’s interest in obtaining debts at a favorable discount is directly at odds with its duty in gaining higher recoveries on the dollar for its client. As Ethical Consideration 5-1 explains,

    The professional judgment of a lawyer should be exercised within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client.

Ethical Consideration 5-2 has particular relevance in illuminating the rules against conflicts of interest:

    After accepting employment, a lawyer carefully should refrain from acquiring a property right or assuming a position that would tend to make his judgment less protective of the interests of his client.5

We conclude, therefore, that a firm’s purchase of any of the debts of its clients for the firm’s action and collection is contrary to the Code of Professional Responsibility.

Under Ohio rules, a Legal Professional Association may not purchase uncollected debts and proceed on them in its own name even if the debts are not owned by a client. Section 1 of Rule III of the Rules for the Government of the Bar confines the activities of legal professional associations to “the practice of law in Ohio and in such other activities only as are essential thereto[.]” The purchase of uncollected debts is not essential to the practice of law and is therefore not permitted. We believe that the policy behind the provision lay in the concern lest the special entity created as the legal professional association be used as a vehicle for other business activities regulated by other provisions of state law.

At the present time, under the Code of Professional Responsibility, a law firm that is not organized as a legal professional association is not prohibited from purchasing uncollected debts not owned by a client, but it may do so only if ethical safeguards are maintained. To begin with, a law firm may not compete with a client for the purchase of debts in which the client has an interest in acquiring. The same requirements for independent professional judgment and the avoidance of conflict of interest with a client apply here as to the purchase of debts owned by a client. In no way should the firm’s interest come between it and its client’s. Competition may raise the price of debts to the client and, in any event, it compromises the disinterested and zealous representation owed to a client. Canon 7.

Nor should a law firm purchase and pursue the collection of smaller consumer debts against individuals in straitened circumstances. Ethical Consideration 2-24 declares, “Every lawyer, regardless of professional prominence or professional workload, should participate in finding time to serve the disadvantaged.” A law firm specializing in

5 Similarly, Ethical Consideration 5-3 states: “After accepting employment, a lawyer should not acquire property rights that would adversely affect his professional judgment in the representation of his client.” See also Ethical Consideration 5-7.
creditors’ rights placing its weight and expertise against the disadvantaged could not avoid the appearance of impropriety contrary to the generic command of Canon 9.

Finally, although a law firm is not prohibited from purchasing some debts on the open market, it should not solicit creditors for the purchase of their debts, nor should it interpose itself between creditor and debtor who may be engaged in a settlement of the dispute between themselves. Any such action would be barratrous and contrary to principles underlying DR 2-103(A) and DR 7-102(A)(1). To buttress its fear of barratry, the American Bar Association held in 1931 that under Canon 28 of the Canons of Professional Ethics, which forbade lawyers to “stir up strife and litigation,”

It is improper for an attorney to buy judgments, notes, and other choses of action from bankrupt estates for the purpose of collecting them for a profit. ABA Formal Opinion 51 (1931).

Although the application of the principle was broader than that under the Code of Professional Responsibility, the obligation not to create or stir up unnecessary legal action remains.

Even where a law firm may purchase debts on the open market under the ethical safeguards outlined above, it may be prudent for a law firm not to initiate such activities at the present time. See Ethical Consideration 9-2. The American Bar Association’s Committee on Professionalism has issued a report noting that the involvement of law firms in ancillary business activities is “disturbing.” The Commission’s report queried, “Has our profession abandoned principle for profit, professionalism for commercialism?” Subsequently, on February 8, 1990, the American Bar Association Section of Litigation issued a draft Recommendation that would prohibit law firms from engaging in non-legal services ancillary to the practice of law, or in establishing a separate entity to do the same, unless those services are “unrelated, and functionally unconnected, to the provision of legal services.” If that recommendation is adopted, the proposed purchase of debts by a law firm specializing in creditor’s rights would fall under that prohibition.

6 Barratry is defined as “The offense of exciting and stirring up quarrels and suits, either at law or otherwise.” BLACK’S LAW DICTIONARY 137 (1979)

7 Accord, ABA Formal Opinion 176 (1938).

8 “When explicit ethical guidance does not exist, a lawyer should determine his conduct by acting in a manner that promotes public confidence in the integrity and efficiency of the legal system and the legal profession.”

9 112 F.R.D. 243, 251 (1986)

10 Recommendation and Report on Law Firms’ Ancillary Business Activities Prepared by the Section of Litigation of the American Bar Association, February 8, 1990. If adopted, the rule would reintroduce the position of ABA Formal Opinion 51 in full force by barrng “attorneys from entering a speculative field, which is profitable and open to laymen.” Op. Cit. See also ABA/BNA Lawyer’s Manual on Professional Conduct, Vol. 6, No. 24, January 2, 1991, p. 429.
CONCLUSION

A law firm is not permitted, under the Code of Professional Responsibility, to purchase any uncollected debts and to collect and prosecute those debts in its own name if the debt is owned by a client. Nor may a law firm seek to purchase any debts in which the client has an interest in acquiring, or any debts in which the firm would be seen as using its expertise to the detriment of the disadvantaged in society.

No legal professional association in the state of Ohio may acquire any debts in its own name for prosecution and collection. A law firm is not prohibited from acquiring debts on the open market provided ethical safeguards are maintained. Caution is advised, however, in that the profession may be moving towards a prohibition of such activities in the future.